

ORIGINAL

Verizon Communications Inc.

Merger Condition I
Separate Advanced Services Affiliate

(Redacted Version)

98-1841

June 18, 2001

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, S.W.
Room TWB-204
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

PricewaterhouseCoopers LLP
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Dear Ms. Salas:

Re: Ex Parte

In the Matter of Applications for Consent to the Transfer Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License, CC Docket No. 98-184

The enclosed materials are being filed pursuant to Verizon Communications Inc.'s ("Verizon") obligations under CC Docket 98-184 Appendix D, Merger Condition 1 ("Advanced Services Merger Conditions"), to engage an independent accountant to perform an agreed-upon procedures engagement regarding Verizon's compliance with the requirements of the Advanced Services Merger Conditions. The accompanying material includes:

- Report of Independent Accountants on Applying Agreed-Upon Procedures related to the Advanced Services Merger Conditions
- The Report of Independent Accountants on Applying Agreed-Upon Procedures related to those procedures agreed to by Verizon and the Joint Federal/State Oversight Team that were performed in connection with the requirements of Section 272 of the Telecommunications Act of 1996. The 272 Report has been included at the request of Verizon and the FCC because certain of the Section 272 affiliates are also separate Advanced Services affiliates.

A separate confidential and proprietary version of this report has been filed under seal of confidentiality with the Office of the Secretary of the FCC.

Very truly yours,

PricewaterhouseCoopers LLP

By

PricewaterhouseCoopers LLP

Enclosures

cc: Ms. Carol Matthey
Mr. Kenneth Moran
Mr. Hugh Boyle
Mr. Anthony Dale

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Report of Independent Accountants on
Applying Agreed-Upon Procedures

To the Management of Verizon Communications Inc.
and the Federal Communications Commission

We have performed the procedures enumerated in Appendix A, which were agreed to by the management of Verizon Communications Inc. ("Verizon") and the Federal Communications Commission (the "FCC") (collectively, the "Specified Users"), solely to assist you in evaluating management's assertion that Verizon complied with the merger conditions as described in CC Docket 98-184 Appendix D, Condition I (the "Advanced Services Merger Conditions") during the period from June 30, 2000 through December 31, 2000 (the "Engagement Period"). This engagement was performed in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the Specified Users of the report. Consequently, we make no representations regarding the sufficiency of the procedures described in Appendix A either for the purpose for which this report has been requested or for any other purposes.

The procedures performed and the results obtained are documented in Appendix A. The procedures and the results of performing such procedures are not intended to be an interpretation of any legal or regulatory rules, regulations or requirements.

We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on Verizon's assertion regarding its compliance with the Advanced Services Merger Conditions. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the management of Verizon and the FCC, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

PricewaterhouseCoopers LLP

June 18, 2001

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The definitions of the following terms are documented in Appendix B: Affiliate; Merger Closing Date; Engagement Period; ILECs; Bell Atlantic/GTE Service Area; separate Advanced Services affiliate(s); Advanced Services; Assets; Customer Care; Permitted Billing and Collection Services; Advanced Services Equipment; Users; Voice Grade Service; Official Services; Network Planning, Engineering, Design, and Assignment Services; and Exclusive Activities.

Objective I: Determine whether the separate Advanced Services affiliates operated independently of the ILECs.

1. We obtained and inspected the certificates of incorporation and bylaws of Verizon Advanced Data, Inc. ("VADI") and noted that VADI was established as a Delaware corporation separate from the Incumbent Local Exchange Carriers (the "ILECs") of Verizon Communications Inc ("Verizon" or the "Company"). Management indicated that, in Delaware, articles of incorporation are known as certificates of incorporation.

We obtained and inspected the articles of incorporation, certificate of incorporation, and bylaws of Verizon Advanced Data-Virginia, Inc. ("VADI-VA") and noted that VADI-VA was established as a Virginia corporation separate from the Verizon ILECs.

We obtained and inspected the certificates of incorporation and bylaws of Verizon Select Services Inc. ("VSSI") and noted that VSSI was established as a Delaware corporation separate from the Verizon ILECs. Management indicated that, in Delaware, articles of incorporation are known as certificates of incorporation.

2. We obtained and inspected the Verizon corporate entities' organizational charts as of December 31, 2000 and confirmed with legal representatives of the ILECs and the separate Advanced Services affiliates the legal, reporting, and operating corporate structures of the separate Advanced Services affiliates. We documented the ownership of the separate Advanced Services affiliates as well as the entities to which the separate Advanced Services affiliates report.

We obtained written confirmations from management noting that VADI is 100% owned by Verizon Ventures III Inc. Verizon Ventures III Inc. has 763 issued and outstanding shares of common stock. Verizon owns one share. The ILECs own the remaining 762 shares. VADI reports to Verizon. VADI-VA is 100% owned by VADI. VADI-VA reports to VADI. Management indicated that VADI-VA has no employees and VADI performs all functions for VADI-VA. VSSI is 100% owned by GTE Corporation, which is owned by Verizon. VSSI reports to GTE Corporation.

3. We obtained a functional organizational chart for VADI as of January 1, 2001 as management indicated that no functional organizational chart as of December 31, 2000 was available. Management developed the functional organizational chart in conjunction with the January 1, 2001 employee transfer. We also obtained a list of employees as of December 31, 2000. We documented for each department the number of employees, street addresses where employees were located, and a description of departmental functions by location. We noted by inspection of the list of employees that VADI employed ****proprietary**** employees as of December 31, 2000 who were classified in the following functional departments: Broadband Data Services and Operations – West, Broadband Data Services and Operations – East, Strategic Planning and Implementation, Advanced Data Product Management and Development,

Planning and Engineering and Implementation, Data Services Network Operations, Customer Care and Service Assurance, Finance, and Group President – Internet and Data Services.

We inquired of management and management indicated there were no VADI-VA employees during the Engagement Period.

We obtained the functional organizational chart for VSSI as of December 31, 2000 and a list of employees that documented the number of employees in each department, the street addresses where the employees were located, and a general description of functions performed at each work location. We noted by inspection of the VSSI functional organizational chart and the list of employees that VSSI employed ****proprietary**** employees as of December 31, 2000 who were classified in the following functional departments: Long Distance Operations – West, Sales and Services – West, Marketing – West, Performance Assurance – West, Card Services – West, Platform Services – West, Sales and Operations – West, Sales – West, Finance – West, Marketing Services – West, and Customer Services – West.

4. We obtained from the separate Advanced Services affiliates a list and description of services offered to the separate Advanced Services affiliates for the Engagement Period by the ILECs and other affiliates. According to management, the services offered are:

Table 1

VADI and VADI-VA	
List of ILEC Services to VADI	ILEC/Affiliate
Order Processing (Functional Equivalency) – customer orders for advance services shall be passed to VADI/VADI-VA for processing and passed back to appropriate Verizon telephone Company which shall provide advanced services to the customer.	All ILECs
Network Planning, Programming and Data Conversion	All ILECs
Universal Service Fund contribution determination	All ILECs
Accounting Services Related to Revenue Recognition Requirements Under the Securities and Exchange Commission Staff Accounting Bulletin #101: Revenue Recognition	All ILECs
Joint Marketing and Customer Care	All ILECs
Programming of Nondiscriminatory Order Processing – includes development of order entry capabilities and interfaces, system support, automated order provisioning feeds, rating of call detail records, maintenance of VADI rate tables, production of a combined bill invoice, support collections and accounts receivable management	Verizon East
Access to Advanced Services Equipment (Resale)	Verizon New York
Billing and Collection Services	All ILECs
Network Testing	Verizon New Jersey, Verizon Washington DC,

VADI and VADI-VA	
List of ILEC Services to VADI	ILEC/Affiliate
	Verizon Maryland, Verizon New York
Training – Joint Marketing related	All ILECs
Operations and Maintenance	Verizon East
Trouble Referrals	All ILECs
Technical Services (use of regional systems)	Verizon New York, Verizon Washington DC, Verizon Maryland, Verizon New Jersey, Verizon Massachusetts
Traffic Data Collection	Verizon West
Interim Capacity (T1 and T3 circuits) – for use of official communication Interlata circuits until commercial alternatives become available	Verizon East
Maintenance of Customer Premises Equipment	Verizon West
Interim Loaned Employees	Verizon East
Installation and Repair of DSL Premise Equipment	Verizon West
Lease of Real Estate	All ILECs
Telephone/Centrex Service	All ILECs
Access services including switched, special, and exchange	All ILECs
Work Stoppage Agreement	Verizon East
Interconnection (collocation)	All ILECs
Network Planning	GTE Consolidated Services
Accounting functions	Verizon Accounting and Information Services
Data Processing	Verizon Accounting and Information Services
Telephones and Wiring	Verizon Connected Solutions Inc
Software Development/System Implementation	Verizon Data Services Inc
LAN WAN Support	Verizon Global Network Inc
DSL Service Order Processing	Verizon High Speed Solutions Corp and Verizon Internet Solutions
Logistics Services for Central Office Purchasing	Verizon Logistics Inc
Network Consulting	Verizon Network Integration Corp
Training Services – Joint Marketing Agreement	Verizon Service Corp
Programming	Verizon Service Corp

Table 2

VSSI	
Description of Services	ILEC/Affiliate
Billing and Collection Services	Verizon West
Capacity (Network Capacity such as DC3, OC3/OC3c, OC12/OC12c, etc)	Verizon California
Technical Support for CPE Equipment	Verizon West
General, Administrative, and Operating Services (Includes but not limited to these services. Ancillary Bill Process, Care Repair Processing, Customer Treatment, Network Management Services, Offline Center Services.	Verizon Southwest

VSSI	
Description of Services	ILEC/Affiliate
Order Removal, Post Order Fulfillment, Product Deployment, Return Mail Center, Service Fulfillment Support, Service Order Processing, Support Assets Services, etc.)	
Inside Wire Installation & Repair Services	Verizon West except Verizon CA and Verizon Midwest
Work Force Management Training	Verizon West
Customer Premise Equipment (CPE) Maintenance	Verizon West
Network Monitoring	Verizon West
National Directory Assistance (includes call completion and branding)	Verizon West
Communication Medium Services to allow VSSI to convey alarms	Verizon West
National Operator Assistance (includes mechanized calling card calls, operator handled calls and call recording)	Verizon West
Acceptance of customer payments in telephone stores	Verizon West
Routing and Rating Database Maintenance (includes input and maintenance of VSSI in the Routing Database System and the Business Rating and Routing Input Database System.	Verizon West
Sales Agency Services (includes promotion and order taking for VSSI products where applicable)	Verizon West
Joint Marketing (See Sales Agency Services)	Verizon West
Slamming/Liability Services (investigation and resolution of activities relating to unauthorized carrier changes)	Verizon Southwest
Provision of Licensed Software (E. Solutions Software)	Verizon West
Technical Support for Licensed Software (See Provision of Licensed Software)	Verizon West
Warm Transfers (VSSI calls received by Verizon West telephone companies are transferred to VSSI)	Verizon West
Voice Messaging (Purchase of residential and business voice messaging service)	Verizon West
Conference Call Connection	Verizon California, Verizon Southwest, Verizon Hawaii & Verizon Florida
Tariff Special Access Services	Verizon West
Tariff Switched Access Services	Verizon West
Tariff Telephone Services (Includes but not limited to local service, centranet, directory assistance, intralata services, etc.)	All ILECs
Interconnection Service (resale)	Verizon West Except Verizon Midwest Plus

VSSI	
Description of Services	ILEC/Affiliate
	Verizon New England Inc. and Verizon Pennsylvania Inc.
Primary Interexchange Carrier Charge	Verizon East
Major Materials	GTE Communication Systems Corporation
Minor Materials and Supplies	GTE Communication Systems Corporation
Contractor-Other Professional, Office, Support Services	GTE Communication Systems Corporation
Internal Telecommunications - Private Line	Verizon Internet Solutions
Lease – Real Property	Verizon Credit Inc.
Internal Telecommunications - Private Line	GTE Overseas Corp.
Mailing Charges	Verizon Directories Corp
Access Charges – Wireless	Verizon Wireless
Internal Telecommunications – Cellular includes toll charges	Verizon Wireless
Access Charges- Capacity (Long Distance Network Business and Residential)	Verizon Global Networks Inc.
Corporate Operations Services	Verizon Services Corp.
Customer Operations Services	Verizon Services Corp.
General & Administrative Services	Verizon Services Corp.
Network Operations Services	Verizon Services Corp.
Network Support Services	Verizon Services Corp.
Customer Billing Services	GTE Consolidated Services Incorporated
Billing and Collection Services	GTE Consolidated Services Incorporated
Executive Services	Verizon Services Group
Accounting/Finance Services	Verizon Services Group
Human Resources Services	Verizon Services Group
Legal Services	Verizon Services Group
Regulatory Services	Verizon Services Group
Public Affair Services	Verizon Services Group
Marketing Services	Verizon Services Group
Engineering Services	Verizon Services Group
Treasury Services	Verizon Services Group
Real Estate Services	Verizon Services Group
Access Charges	Verizon Hawaii International Inc.

5. We obtained the balance sheets and detailed fixed asset listings, which include capitalized software, as of December 31, 2000 for the separate Advanced Service affiliates. We compared the fixed asset balances from the totals listed in VADI's and VADI-VA's detailed fixed asset listings to the fixed asset balances in VADI's and VADI-VA's balance sheets, and noted the following reconciling items:

VADI

Fixed asset balance per VADI's detailed fixed asset listing *****proprietary****

Reconciling items:

Assets Under Construction (purchased from Vendors) ****proprietary****

Internally-Developed Software ****proprietary****

Capitalized Use Tax on East Support Assets ****proprietary****

Accrual for assets purchased¹ ****proprietary****

Amount over NBV on West Assets due to ILECs in January 2001 **(**proprietary**)**

Fixed asset balance per the VADI balance sheet *****proprietary****

¹ The reconciling item "accrual for assets purchased" relates to Verizon West. Due to a timing difference between the year-end conversion in several Verizon West states and the monthly book closing of asset management, the ILEC was not able to provide sufficient detail for a select group of assets that needed to transfer to VADI.

VADI – VA

Fixed asset balance per VADI-VA's detailed fixed asset listing *****proprietary****

Reconciling items:

Assets Under Construction ****proprietary****

Accrual for assets purchased¹ ****proprietary****

Fixed asset balance per the VADI-VA balance sheet *****proprietary****

¹ The reconciling item "accrual for assets purchased" relates to Verizon West. Due to a timing difference between the year-end conversion in several Verizon West states and the monthly book closing of asset management, the ILEC was not able to provide sufficient detail for a select group of assets that needed to transfer to VADI.

VSSI was composed of three financial reporting divisions: VSSI - Long Distance ("VSSI-LD"), VSSI-Solutions, and Verizon Customer Network Solutions ("VSSI-CNS"). We compared the fixed asset balances from the totals listed in each VSSI financial reporting divisions' detailed fixed asset listings to the fixed asset balances in the respective VSSI financial reporting divisions' balance sheets. For VSSI-LD and VSSI Solutions, we noted no differences between the fixed asset balances from the detailed fixed asset listing to the fixed asset balances in the balance sheets. However, for VSSI-CNS, we noted the following reconciling item:

VSSI – CNS

Fixed asset balance per VSSI-CNS detailed fixed asset listing *****proprietary****

Reconciling item:

Assets included in a holding account prior to being placed in service and recorded in fixed asset balance ****proprietary****

Fixed asset balance per the VSSI-CNS balance sheet *****proprietary****

We noted that the detailed listings of fixed assets for the separate Advanced Services affiliates included the description of each item, including the location of the equipment /software, date of purchase, price paid, price recorded, and a notation as to whether it was acquired from an ILEC, affiliate or an unaffiliated entity.

We selected a random sample of 100 facilities and network equipment assets, including software and the land and buildings where those facilities were located, from the VADI and VADI-VA, and VSSI detailed fixed asset listings. We requested invoices for the sample selected.

Management provided invoices for 19 of the 100 VADI and VADI-VA fixed asset selections. We inspected the invoices and noted the following:

- For 18 fixed assets, we inspected invoices and noted the related asset purchases, including one asset transfer, were invoiced by unaffiliated entities to VADI.
- For the following fixed asset, we obtained an invoice that did not provide sufficient information to reconcile to the detailed fixed asset listing:

Table 3

Asset	Location	Vendor	Asset Value
24 Port Switch	New York	Dell	***proprietary**

- Management provided fixed asset transfer schedules from the ILEC to VADI and VADI-VA for the remaining 81 of the 100 sampled fixed assets. We inspected the schedules and noted that VADI and VADI-VA paid the ILECs for the selected assets.

For VSSI, management provided invoices for 39 of the 100 fixed asset selections. We noted the following:

- For 36 fixed assets, we inspected invoices and noted that related asset purchases were invoiced by unaffiliated entities to VSSI.
- For three fixed assets, we inspected invoices and noted that the related fixed asset purchases were invoiced by unaffiliated entities to VSSI. We were unable to reconcile the fixed asset value to the detailed fixed asset listing.

Table 4

Asset	Location	Vendor	Asset Value
Leasehold Improvement	Georgia	***proprietary**	***proprietary**
Sharp Foster(95249)	New Mexico	***proprietary**	***proprietary**
Plan Alpha Server 1000A	Georgia	***proprietary**	***proprietary**

For 61 VSSI fixed assets, we were unable to obtain the invoices. We noted the following:

- Management indicated that 13 of the 61 fixed assets were transfers from the ILEC, and invoices for such transfers were not created.

Table 5

Asset	Location	Vendor	Asset Value
NIP Standard User M/Tower Win95	Texas	Affiliate transfer	***proprietary**
Printer	Texas	Affiliate transfer	***proprietary**
Coupling Flexible 30 RPM	Texas	Affiliate transfer	***proprietary**
ThinkPad 760ELD P100 8MB 810MB CD	Texas	Affiliate transfer	***proprietary**
Office Furniture	Florida	Affiliate transfer	***proprietary**

Asset	Location	Vendor	Asset Value
Projector and Equipment	Oregon	Affiliate transfer	***proprietary**
Misc Equipment	Tennessee	Affiliate transfer	***proprietary**
Furniture	Illinois	Affiliate transfer	***proprietary**
Software ASN Ver 10 System STE	Florida	Affiliate transfer	***proprietary**
Mouse HP-HI-Res W/Mini Din In	Texas	Affiliate transfer	***proprietary**
Converter Video Scan Media PC	Texas	Affiliate transfer	***proprietary**
FSG-Module, VC-62 Compression	Florida	Affiliate transfer	***proprietary**
FSG-IDNX Mux Box	Georgia	Affiliate transfer	***proprietary**

- For seven fixed assets, management indicated that the invoices were not available because invoices are not available for assets transferred from inventory.

Table 6

Asset	Location	Vendor	Asset Price
Epson Action (94148)	New York	Transfer from inventory	***proprietary**
Notebook Contura 96140	Florida	Transfer from inventory	***proprietary**
Notebook Contura96140	Florida	Transfer from inventory	***proprietary**
Laptop (95346)	Michigan	Transfer from inventory	***proprietary**
Laptop Contura (95186)	New York	Transfer from inventory	***proprietary**
Toshiba T125 CDS	Minnesota	Transfer from inventory	***proprietary**
Infotac Modems (96149)	California	Transfer from inventory	***proprietary**

- For 36 fixed assets, management indicated that invoices were not available because invoices are not retained for assets purchased prior to 1995 in accordance with the company's record retention policy.

Table 7

Asset	Location	Purchase Date	Asset Price
Side Chairs	Washington	01/01/1987	***proprietary**
Executive Chair	Georgia	10/01/1987	***proprietary**
Steno Chair	California	03/01/1988	***proprietary**
Data Test Set Network Prob	Missouri	08/01/1986	***proprietary**
RCR N.Y. Credenza 20X72	California	07/01/1987	***proprietary**

Asset	Location	Purchase Date	Asset Price
Gas Detector	Missouri	03/01/1986	***proprietary**
Credenza	Georgia	05/01/1987	***proprietary**
Desk	Georgia	05/01/1987	***proprietary**
2 Shelf Bookcase	Georgia	01/01/1987	***proprietary**
Oak Desk	California	09/01/1987	***proprietary**
Medium Wood Book Case	California	09/01/1987	***proprietary**
Metal Table	California	09/01/1987	***proprietary**
Bookcase	Arkansas	12/01/1989	***proprietary**
Tubular Metal Vinyl Chair	Illinois	12/01/1989	***proprietary**
IBM CORR SLCT 2 Typewriter	Texas	12/01/1989	***proprietary**
Pedestal Fan	Texas	12/01/1989	***proprietary**
Shelving Section	Texas	12/01/1989	***proprietary**
Side Chair	Texas	02/01/1990	***proprietary**
Chair	Texas	02/01/1990	***proprietary**
Oriental Brass Bonsai Tree	Texas	02/01/1990	***proprietary**
File	Arkansas	12/01/1989	***proprietary**
Bookcase	Kansas	12/01/1989	***proprietary**
Chair	Kansas	12/01/1989	***proprietary**
Shelving Unit	Oklahoma	12/01/1989	***proprietary**
Shelving Unit	Oklahoma	12/01/1989	***proprietary**
Shelving Unit	Texas	12/01/1989	***proprietary**
Shelving Unit	Texas	12/01/1989	***proprietary**
Desk	Texas	12/01/1989	***proprietary**
Legal File (4 Drawer)	California	07/01/1990	***proprietary**
Window Coverings-Webb	California	07/01/1990	***proprietary**
Cellular (92048)	Texas	07/01/1992	***proprietary**
Burgandy Desk (94003)	Georgia	02/01/1994	***proprietary**
Burgandy Desk (94003)	Georgia	02/01/1994	***proprietary**
Credenza (94043)	Georgia	06/01/1994	***proprietary**
HP DeskJet 500 (93002)	California	10/01/1992	***proprietary**
Versa-NEC Notebook (94040)	Texas	04/01/1994	***proprietary**

- Management indicated that invoices were not available for 2 of the 61 fixed assets, which were purchased subsequent to 1994.

Table 8

Asset	Location	Purchase Date	Asset Price
PC220 SL 5/100 16MB,1.2GB HD	Florida	01/01/1998	**proprietary**
Laptop Z-PAS250U- S6C	Virginia	07/01/1999	**proprietary**

- For three fixed assets we were unable to obtain information necessary to verify that the related fixed asset purchases were invoiced by unaffiliated entities to VSSI.

Table 9

Asset	Location	Asset Price
TI TSET Equipment	Texas	**proprietary**
Toshiba 8000 Notebook	Texas	**proprietary**
8000 Notebook	California	**proprietary**

Objective II: Determine whether the separate Advanced Services affiliates maintained books, records, and accounts in the manner prescribed by the Commission that are separate from the books, records, and accounts maintained by the ILECs.

1. We obtained the general ledgers of VADI and VADI-VA as of December 31, 2000. We compared the titles on the VADI and VADI-VA general ledgers with the names on the VADI and VADI-VA certificates of incorporation and noted no differences. We requested the VSSI general ledger and management indicated that there was no consolidated general ledger for VSSI; however separate ledgers were maintained for the divisions of VSSI. We obtained the general ledgers of the three divisions. For VSSI, we noted the title on the certificate of incorporation was "Verizon Select Services Inc." which did not specify the separate VSSI operating divisions. We noted no special codes that linked the separate Advanced Services affiliates' general ledgers to the ILECs' general ledgers.
2. We obtained the separate Advanced Services affiliates' written accounting policies and procedures. We inquired of management and documented our understanding of the accounting systems, processes, transaction flows and control points impacting revenue, accounts receivable, cash receipts, purchasing, accounts payable, cash disbursements, payroll, leases and fixed assets related to the proper identification and recording of the separate Advanced Services affiliates' transactions in their separate books of accounts and we summarized our understanding as follows:

VADI and VADI-VA

General Overview of Accounting System

- VADI utilizes PeopleSoft and SAP accounting systems, which are separate and distinct from ILEC PeopleSoft accounting systems.
- VADI maintains its own Information Technology ("IT") department which oversees VADI accounting systems and is separate from the IT department of the ILECs.
- VADI maintains a separate chart of accounts which is different and separate from the ILECs.
- VADI is segregated from the ILECs on financial statements/general ledgers/other reports by use of a unique business code.
- Access rights to the accounting systems are granted by VADI's IT department, and are approved by VADI management.

Revenue, Accounts Receivable, Cash Receipts

- Advanced Services must be ordered through VADI ordering systems that are directly linked to VADI provisioning systems. The ordering systems of the ILECs do not have the ability to accept orders for Advanced Services.
- VADI personnel have access to the billing codes for Advanced Services. ILEC billing systems do not include the billing codes for Advanced Services.

Purchasing, Accounts Payable, Cash Disbursements

- VADI is structured with a purchasing organization that is separate from the ILECs.
- VADI utilizes separate purchasing systems with a unique VADI access code restricted to authorized VADI and/or Verizon Accounting and Information Services personnel. Verizon Accounting and Information Services is an administrative organization that provides accounting services under a contract to VADI. Verizon Accounting and Information Services does not provide services to ILECs.
- Purchase orders are authorized by VADI personnel. Vendor payments are processed by the VADI Accounts Payable voucher system.

- Cash disbursements are transacted through VADI's unique bank accounts.
- Cash management services are provided by Verizon Global Funding Inc., which does not provide cash management services to the ILECs.

Payroll

- VADI utilizes two payroll systems (SAP and PeopleSoft) with unique VADI codes for each paid employee.
- Only authorized VADI personnel can enter time keeping information into the payroll systems.
- All VADI payroll disbursements are charged to a unique bank account. Various encryption controls are utilized to ensure that all checks generated are coded to the unique VADI bank account.
- An electronic fund transfer file is generated from both payroll systems containing the unique VADI bank account and other bank routing information.

Fixed Assets

- Capital expenditures are recorded in the VADI purchasing systems that utilize a unique VADI code and are only accessible by authorized VADI employees.
- The asset management systems for VADI utilize a unique Company code and are only accessible by authorized VADI employees.
- Appropriate VADI personnel approve purchase orders and invoices. Assets received are reconciled to the purchase order, accounts payable, and asset management systems.

VSSI

General Overview of Accounting System

- VSSI-LD and VSSI-Solutions use SAP and separate Company codes in the accounting system.
- All accounting records for VSSI-CNS are recorded and maintained on a separate general ledger system, Dispatch-1 ("D1"). D1 is an integrated accounting/service/billing system that is uniquely dedicated to VSSI-CNS's activities and separate from the accounting system of the ILECs.
- Both D1 and SAP systems require a unique user identification and password. Also, specific profiles are assigned for each user identification restricting access to areas commensurate with the Specified Users' responsibility.

Revenue, Accounts Receivable, Cash Receipts

- VSSI-LD and VSSI-Solutions have unique carrier identification codes to properly identify and route orders to the appropriate legal entity.
- The VSSI divisions utilize billing systems that are separate from the ILEC billing systems. Revenue Billings and Accounts Receivable information is interfaced to the SAP and D1 accounting systems.

Purchasing, Accounts Payable, Cash Disbursements

- VSSI purchasing systems are password protected and are restricted to authorized VSSI employees.
- VSSI-LD and VSSI-Solutions use separate Company codes in SAP. When an invoice is received, the purchase order, and invoice are automatically matched in SAP.
- VSSI-CNS uses D1, which is separate from the accounting system of the ILECs. A unique Company code assigns Purchase Orders, Material Receipts and Invoices to the appropriate Company.

Payroll

- VSSI utilizes the SAP payroll system which assigns a unique company code to each employee.
- Only authorized VSSI personnel can enter time information into the payroll system.
- All VSSI payroll disbursements are charged to a unique VSSI bank account based on the VSSI company code.
- An electronic fund transfer file is generated from the payroll systems containing the unique VSSI bank account and other bank routing information.

Fixed Assets

- VSSI-LD and VSSI-Solutions have separate company codes in SAP. Only Asset Accounting personnel with appropriate security clearance per their job function may record transactions to these separate company codes.
 - VSSI-CNS uses D1, which is separate from the accounting systems used by the ILEC, to record fixed assets. Access to the D1 system is restricted to authorized VSSI personnel.
3. We obtained the December 2000 Verizon Global Funding “line of credit reports” for VADI, VADI-VA, VSSI-LD, and VSSI-CNS. Management indicated that VSSI-Solutions did not maintain a line of credit with Verizon Global Funding, however VSSI-Solutions maintained a line of credit with the GTE Treasury Group. The GTE Treasury Group is a functional organization of Verizon Services Group.
 4. Using the information obtained in Objective II, Procedure 2, we selected one cash receipt, cash disbursement, and payroll transaction each for VADI and VSSI. Management indicated that the transaction policies, procedures and controls were the same for VADI and VADI-VA.

VADI

We selected a cash receipt from the December 2000 Global Funding “line of credit report”. Management indicated that cash receipts were processed pursuant to a billing and collections (“B&C”) agreement. In order to perform a walkthrough of this transaction, we obtained and reviewed the December PeopleSoft general ledger entry made to record the transaction and we noted that the transaction was recorded in the general ledger.

We selected a VADI cash disbursement from the December 2000 Global funding “line of credit report.” In order to perform a walkthrough of this transaction, we obtained and inspected the Approval and Classification of Bills for payment, check paid, and bank statement. We obtained and inspected the December 2000 PeopleSoft general ledger entry made to record the transaction and we noted that the transaction was recorded in the general ledger.

We selected a VADI payroll transaction from the December 2000 Verizon Global Funding “line of credit report.” In order to perform a walkthrough of this transaction, we obtained and inspected the payroll authorization, earnings, taxes and distribution report, VADI Payroll Advice Register, and bank statement. We obtained and inspected the December PeopleSoft general ledger entry made to record the transaction and we noted that it was recorded in the general ledger.

VSSI

We selected a cash receipt from the lockbox master batch listing on December 15, 2000. In order to perform a walkthrough of this transaction, we obtained and reviewed the bank statement, the billed invoice, check received, and the accounts receivable customer detail. We obtained and inspected the

December SAP general ledger entry made to record the transaction and noted that it was recorded in the general ledger.

We selected a cash disbursement from the check register on December 15, 2000. Management indicated that the SAP accounting system automatically assigns a document number to the check when issued, and this serves as the journal entry. Management indicated the cash entry is posted periodically in the SAP general ledger. In order to perform the walkthrough, we obtained and inspected a download from SAP of the related cash entry made on January 7, 2001 that covered the posting of the selected cash disbursement.

We selected the VSSI payroll disbursement on December 19, 2000. In order to perform a walkthrough of this transaction, we obtained and inspected the check register, SAP general ledger report, and a bank statement. We obtained and inspected the December SAP general ledger entry made to record the transaction and noted that it was recorded in the general ledger.

5. We obtained the separate Advanced Services affiliates' financial statements and listings of lease agreements as of December 31, 2000. We identified leases for which the annual obligation was \$500,000 or more. We judgmentally selected and obtained the lease agreements for five VADI and five VSSI leases and noted the terms and conditions. Management indicated that VADI-VA did not enter into any lease agreements. We obtained and inspected the Company's lease accounting policies and the "Statement of Financial Accounting Standards No. 13, *Accounting for Leases*" assessment prepared by management indicating the accounting treatment determined by management for each lease. We noted that for three of the VADI lease agreements selected, the assessment was prepared in accordance with the Company's lease accounting policies. We noted such accounting policies were consistent with GAAP. For the remaining two VADI leases and for the five VSSI selections, we requested from management but did not receive the fair market values of the properties or equipment. Consequently, we were unable to make a determination based upon the information provided.

Objective III: Determine whether the separate Advanced Services affiliates had officers, directors, and employees that were separate from those of the ILEC.

1. We obtained the policies and procedures for the ILECs, VADI, and VADI-VA for transferring, sharing, and loaning employees among each other. We also obtained VSSI's policies and procedures for transferring employees. Management indicated that VSSI does not have written policies and procedures for sharing and loaning employees. Management also indicated that loaning or sharing of employees between the ILECs and VSSI is not allowed. Management indicated that no employees were loaned or shared between the ILECs and VSSI during Engagement Period. Through inspection of the ILEC, VADI, and VADI-VA policies and procedures and inquiry of management, we noted and documented the types of internal controls in place that would prevent one from being an officer, director, or employee of both the ILECs and separate Advanced Service affiliates simultaneously. Management indicated that employees were permitted to transfer between an ILEC and the separate Advanced Services affiliates; however, the loaning or sharing of employees was not permitted.

The Verizon controls in place that would prevent an individual from simultaneously being an officer, director, or employee of both the ILECs and separate Advanced Services affiliates are as follows:

- Selection of Directors and Officers – Management indicated the Corporate Governance Group (“CGG”) is responsible for managing the requirement for the ILECs and separate Advanced Services affiliates to have separate officers and directors. Potential officer and director candidates are compared to the roster of current separate Advanced Services affiliate and ILEC director and officer listings by the CGG and reviewed by the legal department and the Affiliate Interest Compliance Office. If a match is found that is inconsistent with the separate Advanced Services affiliate separation requirements, a request is put in for a new candidate.
- Transfers of Employees - When an employee from an ILEC accepts a job offer at a separate Advanced Services affiliate, or an employee from a separate Advanced Services affiliate accepts an offer at an ILEC, the affiliate human resources representative issues an Employee Action Record to notify the payroll staff of the new employee, the employee's start date and other critical information. The payroll staff representative then notifies the regulated corporate payroll staff of the impending transaction and requests a Reassignment – Transfer Checklist and a Transfer Form, which are completed by the corporate payroll staff and forwarded to the non-regulated payroll and employee change records teams, to ensure the individual is not on the payroll of both a separate Advanced Services affiliate and an ILEC at the same time.

In order to determine that employees are not simultaneously working for more than one entity, the payroll systems, although different for the ILECs and the separate Advanced Services affiliates, are reconciled by Verizon Communication's corporate payroll department records. The system will not allow more than one payment to a social security number in a given pay cycle.

2. We inquired of management and management indicated that the separate Advanced Services affiliates and the ILECs maintained separate boards of directors and separate officers.

We obtained a list of officer and director names and corresponding dates of service to the ILECs and the separate Advanced Services affiliates for the Engagement Period. We compared the list of officers and directors of the ILECs to the list of officers and directors of the separate Advanced Services affiliates and noted that no names appeared on both lists.

We obtained and inspected the minutes of the meetings of the boards of directors and/or written consents of the stockholders electing the boards of directors for the ILECs and the separate Advanced Services affiliates for the Engagement Period and compared and documented the names appearing on

the minutes of the ILECs and the separate Advanced Services affiliates. We noted no instances where an individual simultaneously served as a director or officer of both an ILEC and a separate Advanced Services affiliate.

3. We obtained a functional organizational chart for VADI as of January 1, 2001 as management indicated that no functional organizational chart as of December 31, 2000 was available. We noted that, as of January 1, 2001, no departments reported either functionally or administratively (directly or indirectly) to an officer of the ILECs. We obtained and inspected the functional organizational charts for VSSI as of December 31, 2000 and noted that no departments reported either functionally or administratively (directly or indirectly) to an officer of the ILECs.
4. We obtained the files containing the year-to-date payroll information for each separate Advanced Services affiliate and each ILEC that included the social security numbers of employees as of the end of the Engagement Period. We inquired of management and management indicated that some officers and directors of the ILECs and the separate Advanced Services affiliates were employees of Network Services Inc. d/b/a Verizon Services Corp., Telesector Resource Group, d/b/a Verizon Services Group, or GTE Services d/b/a Verizon Services Group and, therefore, were not included in the payroll.

We designed and executed a program that electronically compared social security numbers of employees on VADI's and VSSI's lists to the ILECs' listings. We noted no VADI employees who appeared on both lists. Management indicated that employees were transferred from the ILECs to VADI on January 1, 2001 as described in a letter to the FCC dated December 18, 2000. We selected a random sample of 25 employees of the 161 VSSI employees appearing on both lists. We obtained detailed payroll records and verified that none of the employees selected had been simultaneously on an ILEC and separate Advanced Services affiliate payroll.

Management indicated that there were no VADI-VA employees during the Engagement Period.

5. We obtained a list of officers and employees who transferred from an ILEC to a separate Advanced Services affiliate during the Evaluation period. We selected a random sample of 25 transferred VADI employees and 25 transferred VSSI employees to determine that the controls documented in Objective III, Procedure 1 were applied by inspecting employees' employment history from the Verizon Employment Information System ("EIS"). By reference to the EIS histories only, we noted no instances where an individual was simultaneously employed by an ILEC and a separate Advanced Services affiliate. We requested and received written confirmation from 24 of 25 VADI employees, and 13 of 26 VSSI employees, stating that they had been trained on the use of proprietary information. We received confirmations from 4 VSSI employees stating that they had not been trained on the use of proprietary information. Management indicated that 1 VADI confirmation was not received because the employee was on disability leave, and 3 VSSI confirmations were not received because the employees have left the company.

Management indicated that for the unique purpose of transferring ILEC employees to the separate Advanced Services affiliate on December 24, 2000 (Verizon West) and January 1, 2001 (Verizon East), standard human resource forms were not used. Spreadsheets containing the fields required by the Payroll and Human Resources Departments were developed to effect and approve the transfers.

Management indicated that VADI-VA had no employees during the Engagement Period.

Objective IV: Determine that the separate Advanced Services affiliates did not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the ILEC.

1. We documented each separate Advanced Services affiliate's debt arrangements, noting that these debt arrangements were with related parties, Verizon Global Funding and GTE Corporation. Management indicated there was no credit arrangement with lenders and major suppliers of goods and services in effect during the Engagement Period. Major suppliers are defined as those having \$500,000 or more in annual sales to the separate Advanced Service affiliate. Upon review of the debt arrangements, we did not note any language indicating guarantees or recourse to the ILECs' assets, either directly or indirectly through another affiliate.
2. We obtained the lease agreements (where the annual obligation was \$500,000 or more) used in Objective II, Procedure 5 which documented the terms and conditions of the separate Advanced Services affiliates' leases. We did not note any language in these agreements indicating recourse to the ILECs' assets, either directly or indirectly through another affiliate.

We obtained a list of employee work locations for the separate Advanced Service affiliates and compared these lists to the listing of lease agreements obtained in Objective II, Procedure 5. We noted four locations where VADI employees worked without a lease agreement:

- Grapevine, TX
- Baltimore, MD
- Erie, PA
- Marlborough, Massachusetts

We noted six locations where VSSI employees worked without a lease agreement:

- Youngsville, LA
- Dedham, MA
- Dallas, TX
- Houston, TX
- New York, NY
- Hazelwood, MD

Management indicated that VADI-VA had no employees during the Engagement Period.

3. We requested and received positive confirmation from Verizon Global Funding and the GTE Treasury Group confirming lack of recourse to the ILECs' assets for the debt agreements with VADI, VADI-VA and VSSI. We inquired of management and management indicated that ILECs are the lessors in all VADI leases sampled. As a result, confirmations attesting to lack of recourse to the ILECs assets were not sent to the ILECs. Management indicated that VADI-VA did not have lease agreements or credit arrangements.

We requested positive written confirmation for six VSSI leases with annual payment obligations in excess of \$500,000 and for a judgmental sample of 10 VSSI leases with annual payment obligation less than \$500,000 to attest to lack of recourse to ILEC assets. We received responses from 5 of the 16 lessors to which confirmation requests were sent, confirming they did not have recourse to the ILECs' assets.

4. We obtained the general ledgers for the separate Advanced Services affiliates and documented the balances of accounts payable to the ILECs at December 31, 2000. We noted no balances for

advances from the ILECs in the general ledgers of the separate Advanced Services affiliates. The following represents the balance of accounts payable to the ILECs as of December 31, 2000.

VADI

GTE California Operations	\$*proprietary
GTE Florida Operations	*proprietary
GTE Hawaii Operations	*proprietary
GTE Midwest, Inc.	*proprietary
GTE North, Inc.	*proprietary
GTE Northwest, Inc.	*proprietary
GTE South, Inc.	*proprietary
GTE Southwest, Inc.	*proprietary
GTE Systems of the South	*proprietary
GTE West Coast, Inc.	*proprietary
Total Accounts Payable to ILECs	<u>\$*proprietary</u>

We noted no balance of accounts payable to the ILECs at December 31, 2000 for VADI-VA.

VSSI - LD

GTE Southwest, Inc.	\$*proprietary
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We noted no balance of accounts payable to the ILECs at December 31, 2000 for VSSI-Solutions or VSSI-CNS.

Objectives V & VI: Determine whether the separate Advanced Services affiliates conducted all transactions with the ILECs on an arm's length basis with the transactions reduced to writing and available for public inspection and determine whether the ILECs accounted for all transactions with the separate Advanced Services affiliates in accordance with the accounting principles and rules approved by the FCC.

1. We documented the procedures used by the ILECs and the Corporate Compliance Officer to identify, track, respond, and take corrective action to complaints relating to alleged noncompliance with the Advanced Services provisions of the BA/GTE Merger Conditions. Management indicated that the regulatory liaison department is responsible for monitoring the complaint process. When a complaint arises, a complaint manager is assigned, who, with the assistance of a representative from the line of business that is impacted by the complaint, is responsible for investigating the complaint. The complaint manager is responsible for compiling a formal response, including the corrective actions to be taken. A database is maintained by the regulatory liaison department to track the status of all complaints including the final resolutions thereto.

We requested a list of all FCC formal complaints, as defined in 47 CFR 1.720; FCC informal complaints, as defined in 47 CFR 1.716; and any written complaints made to a state regulatory commission from competitors involving alleged noncompliance with the Advanced Services provisions of the BA/GTE Merger Conditions, including complaints submitted by competitors related to the provision or procurement of goods, services, facilities, and information, or in connection with the establishment of standards. Management indicated that no FCC formal or informal complaints or any written complaints made to state regulatory commissions from competitors involving alleged noncompliance with the Advanced Services associated with the provision or procurement of goods, services, facilities, and information, or in the establishment of standards have been received by Verizon up to the date of this report.

2. We obtained from the ILECs and the separate Advanced Services affiliates current written procedures for transactions with affiliates and compared these procedures with the FCC Rules and Regulations, including: 32.27; 53. (203(e)); 64.901, and 64.902; paragraphs 122, 124, 183 and 265 of the *Report and Order* in CC Docket No. 96-150, issued December 1996, concerning Accounting Safeguards Under the Telecommunications Act of 1996 (11 FCC Rcd 17539 (1996)); paragraph 193 of the "First Report and Order and Further Notice of Proposed Rulemaking" in CC Docket 96-149, issued December 1996, concerning Non-Accounting Safeguards under Sections 271 and 272 of the Communications of the Communications Act of 1996; and paragraph 337 of the Memorandum Opinion and Order in CC Docket No. 98-121, issued October 13, 1998, concerning BellSouth's 271 application in Louisiana. We did not note any differences between the Company's written procedures and the FCC rules and regulations listed above.
3. We inquired and documented how the ILECs and the separate Advanced Services affiliates disseminate the FCC Rules and Regulations and the conditions of the Merger Agreement and raise awareness among employees for compliance with the rules listed in Objective V & VI, Procedure 2. This documentation includes a description of the type and frequency of training, literature distributed, each Company's policy and the names of supervision employees responsible for ensuring compliance with these rules. The following activities have taken place among the ILECs and separate Advanced Services affiliates employees:
 - On July 7, 2000, the Senior Vice President Regulatory Compliance, issued a letter to the top 300 senior executives of Verizon outlining the importance of complying with the various affiliate rules, including those associated with the merger conditions and requested this letter be cascaded broadly.

- During the fourth quarter of 2000, electronic mail was sent from the Affiliate Interest Compliance Office to various ILEC organizations outlining the availability of training materials related to “rules of engagement, i.e., as to how regulated telephone companies are to interact with Advanced Services Affiliates in accordance with the merger conditions.”
- An electronic presentation for use in familiarizing employees with the rules of engagement and a list of questions to assist employees in determining if they need to participate in the training, were forwarded within Verizon’s respective organizations. These organizations then began to schedule training sessions with the Affiliate Interest Compliance Office or to review the information on their own.
- A computer-based training package related to the separate Advanced Services affiliates, which includes a section on compliance with the regulatory rules, was developed with the “rules of engagement” input from the Affiliate Interest Compliance Office. This training package can be found at <http://netlearn.verizon.com>.
- A compliance office was established to help monitor all regulatory compliance-related activity.
- An internal website was developed by Verizon to post various compliance-related documents such as the Affiliate Transaction Policy Statement.
- A toll-free number was established to answer all employee affiliate transaction related questions.

We requested that employees responsible for the development and recording of transactions affected by these rules in the books or records of the carrier complete a questionnaire regarding their awareness of the FCC Rules and Regulations governing affiliate transactions. We interviewed these employees and documented their awareness of these rules. The following are the positions held by these employees:

- Specialist in Finance Operations, Special Purpose Billing-Verizon East
 - Manager of Affiliate Billing in Corporate Books-Verizon East
 - Manager of Affiliate Billing in Finance-Verizon East
 - Senior Specialist in Enterprise Solutions Group-Verizon East
 - Senior Specialist in B&C Account Management-Verizon East
 - Manager of Performance Assurance in Real Estate-Verizon East and Verizon West
 - Senior Market Manager of B&C in Wholesale Billing Operations-Verizon West
 - Manager of Affiliate Transactions in Corporate Accounting-Verizon West
 - Accounting Manager of VADI Finance
 - Product Manager of Wireless and CLEC Wholesale Operator Services
 - Assistant Market Manager of Wholesale Operator Services
4. We obtained the written agreements, including interconnection agreements, for services and for equipment/facilities between the ILECs and the separate Advanced Services affiliates, which were in effect during the Engagement Period. We summarized these agreements and documented the names of parties, types of services, rates, terms, and conditions. We compared the services rendered by the ILECs to the separate Advanced Services affiliates under these agreements with the list of services offered to the separate Advanced Services affiliates in Objective I, Procedure 4 and noted no differences between the list of services provided in Objective I, Procedure 4 and the services listed in the agreements for VADI. We noted the following difference for VSSI:
- Tariff Special Access Services, Tariff Switched Access Services, and Tariff Telephone Services are included in the Objective I, Procedure 4 list but are not included in written agreements obtained in Objective V/VI, Procedure 4. These services are purchased for VSSI’s own use. They are purchased in accordance with the ILEC’s publicly filed and approved state and federal tariffs.